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## REACHING ASSETS OF THE LIMITED PARTNER—A NEW AVENUE OF ATTACK?: *WATTENBARGER v. SAUNDERS*

The case of *Wattenbarger v. Saunders*<sup>1</sup> may prove to be a vital influence within the field of creditor's rights. It purports, for the first time in California, to interpret section 15511 of the California Corporations Code<sup>2</sup> in such a way as to preclude the fraudulent or bad faith application of this section by a partner desiring to defraud the general creditors of a debtor-partnership.

This was an action by a creditor of the partnership. The defendant, Saunders, had executed on the same day two documents affiliating him with the debtor-partnership. One of these was a certificate of doing business under a fictitious name which represented him as a general partner.<sup>3</sup> The other was a certificate of limited partnership which, he alleged, made him only a limited partner and therefore not liable for the debts of the partnership.<sup>4</sup>

Defendant filed the limited partnership certificate about two weeks after its execution, and then one month later he filed the certificate of doing business under a fictitious name and caused it to be published in a newspaper of general circulation. Plaintiff, a creditor of the partnership, alleged that this publication of the certificate of doing business under a fictitious name clearly indicated to him and to the general public that defendant was a general partner, and also that he relied on this representation when he extended credit to the partnership, having faith in the defendant's business and financial reputation. He argued that the acts of the defendant made him liable for the debts of the partnership.

Defendant answered and defended solely on the grounds that he had complied with section 15511 of the California Corporations Code, that this constituted him a limited partner, and that, as such, he was not liable to general creditors of the partnership.

In the summary judgment below, plaintiff's cause of action had been dismissed, but the District Court of Appeal reversed that dismissal and decreed that there were "factual questions for the trial court's determination as to whether defendant's belief that he was contributing . . . as a limited partner was 'erroneous,' as required by the statute, or whether he acted *in good faith*." [Emphasis of the court.] Further, "a mere statement . . . where one claims and believes he has become a limited partner, is not in and of itself sufficient as a matter of law to avoid liability . . . where the evidence is in conflict as to whether his belief was *erroneous* or whether he acted *in good faith*." [Emphasis

<sup>1</sup> 191 Cal. App. 2d 857, 13 Cal. Rptr. 92 (1961).

<sup>2</sup> CAL. CORP. CODE § 15511. Which provides: "A person who has contributed to the capital of a business conducted by a person or partnership erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership; provided, that on ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income." This section is commonly known and referred to by the court as the "escape clause."

<sup>3</sup> Designed to give public notice of the true names of individuals doing business under a fictitious name or names of all members of a partnership where the firm name does not disclose the names of all the partners. CAL. CIV. CODE § 2466.

<sup>4</sup> A requisite for becoming a limited partner in California. CAL. CORP. CODE § 15502.

of the court.]<sup>5</sup> In these words, the court interpreted section 15511 of the Corporations Code, for the first time, as requiring good faith compliance as a condition precedent to its application, and thus opened up a new avenue of attack for the creditor of the partnership.

The court's requirement that the defendant-partner must have acted in good faith before his compliance with the statute will act to release him from partnership liability appears to be a sound and reasonable interpretation of the statute, calculated to carry out its true intent and meaning.<sup>6</sup> At the same time, this interpretation protects the partnership's creditor from a fraudulent or bad faith use of the escape clause.

The presence of the word "erroneously" in the clause indicates that the drawers of the Uniform Limited Partnership Act intended that the benefit of the clause be available only to a partner who genuinely believed himself to be a limited partner, and one who promptly took steps to rectify his mistake upon discovering that he had not complied with the necessary procedure for becoming such. The additional requirement of good faith compliance with the clause by the partner is only a clarification of the wording of the clause, emphasizing that the clause is to be used only as a shield for the good faith limited partner, not as a sword by a defrauder. Without the requirement of good faith for application of the clause, it would, in the words of the court, "truly amount to an 'escape provision' for those acting in bad faith and with an intent to defraud creditors. . . ."<sup>7</sup>

This is certainly not a unique or controversial interpretation of the escape clause. Its soundness appears so obvious and its logic so unassailable that it seems surprising that the court was unable to cite a single case which supported this view.

The two leading cases in the country which decided in favor of a partner who defends against liability on the grounds of compliance with the escape clause do not mention the aspect of good faith.<sup>8</sup> The defendant's good faith was so obvious in both that it was not a point of contention.

The court was not so much on unbroken ground as it believed, however. As long ago as 1903, a Virginia court greatly reduced a partner's liability for the debts of the partnership solely because of his good faith attempt to form a limited partnership.<sup>9</sup> More recently, in the middle 1940's, a Panama Canal Zone case allowed the defendant partner to recover property taken as payment for delinquent partnership debts because of his good faith compliance with all of the statutory provisions.<sup>10</sup> Although these cases are not directly in point with the *Wattenbarger* case they do lend support to the decision.

Aside from these cases, other sources which, in general, lend support to this decision are several law review articles which deal with a good faith require-

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<sup>5</sup> 191 Cal. App. 2d at 863, 13 Cal. Rptr. at 95.

<sup>6</sup> For legislative history and intent of Uniform Limited Partnership Act, see Chel, *The Limited Partnership*, 2 U.C.L.A. L. REV. 105 (1954).

<sup>7</sup> 191 Cal. App. 2d at 863, 13 Cal. Rptr. at 95.

<sup>8</sup> *Gilman Paint and Varnish Co. v. Legum*, 155 Md. 232, 80 A.2d 757 (1951); *Rathke v. Griffith*, 36 Wash. 2d 394, 218 P.2d 906 (1950).

<sup>9</sup> *Deckert v. Chesapeake Western Co.*, 101 Va. 804, 45 S.E. 799 (1903).

<sup>10</sup> *Playa de Flor Land Co. v. United States*, 70 F. Supp. 281 (D.C. Canal Zone 1945).

ment in complying with the escape clause,<sup>11</sup> but none of these writers took as forceful or direct a stand as the *Wattenbarger* decision. Only Witkin, in his *California Law Summary*, actually uses the words "good faith" when referring to the requirements of section 15511 of the California Corporations Code: "[T]he act, however, contains an escape provision for one who acts mistakenly but in good faith."<sup>12</sup>

Because of its status as a precedent, the *Wattenbarger* case is certain to have its influence upon the field of creditor's rights. Its effect should be two-fold: First, it will assure the creditor and his attorney that a defendant-partner of a debtor-partnership will not be allowed to escape liability for the partnership's debts by a fraudulent or bad faith use of the escape clause; and secondly, it will simplify the creditor's attorney's task by allowing him to establish the defendant's liability on the relatively easily constructed basis of his being a general partner rather than the more difficult and tediously proved basis of misrepresentation. In cases such as the *Wattenbarger* case, the creditor's attorney will need to concern himself only with proving a lack of good faith compliance with the escape clause and will not have to face the rigors of proving reliance, inducement, scienter, or its substitutes which would be required for proving liability on a misrepresentation basis. Once the attorney has proved lack of good faith, the defendant is then automatically considered a general partner and as such he is liable to the creditor for all partnership debts.

Unfortunately, one aspect of this opinion may operate to dilute the status of the case as a precedent. The opinion was concerned primarily with good faith compliance with the escape clause, as heretofore stated, and omitted serious discussion of the other ground upon which the defendant's liability could have been based, that of misrepresentation.

The court's only references to misrepresentation appear to be wholly incidental to the main theme of lack of good faith. The court indicated that a question of fact was presented as to whether defendant held himself out to the public as a general partner, but it seemed to consider this only insofar as it weighed on the issue of good faith, not as grounds for liability in itself.

One California case,<sup>13</sup> cited by the court in connection with a different point, held the defendant liable to a partnership's creditor on a showing of facts similar to the *Wattenbarger* case on the grounds of misrepresentation set out in California Corporations Code, section 15016.<sup>14</sup> This liability was not based upon any partnership status of the defendant and was operative whether he was a full partner, a limited partner, or no partner at all. Although in *Wattenbarger* the court omits any discussion of this point, it would seem that section 15016 is applicable. According to plaintiff's allegations, defendant caused him-

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<sup>11</sup> Chel, *The Limited Partnership*, 2 U.C.L.A. L. REV. 105, 116-18 (1954); Ballantine, *Adoption of Uniform Partnership Act in California*, 17 CALIF. L. REV. 623, 630 (1929); Annot., 18 A.L.R. 2d 1360 (1950).

<sup>12</sup> 3 WITKIN, *SUMMARY OF CALIFORNIA LAW Partnership* § 38 (7th ed. 1960).

<sup>13</sup> *Hunter v. Croysdill*, 169 Cal. App. 2d 307, 337 P.2d 174 (1959).

<sup>14</sup> CAL. CORP. CODE § 15016: "When a person, by words spoken or written or by conduct, represents himself . . . as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the . . . apparent partnership . . ."